

THE REGIONAL AIRLINE INDUSTRY IN THE US AND EUROPE: CURRENT TRENDS AND FUTURE OUTLOOK

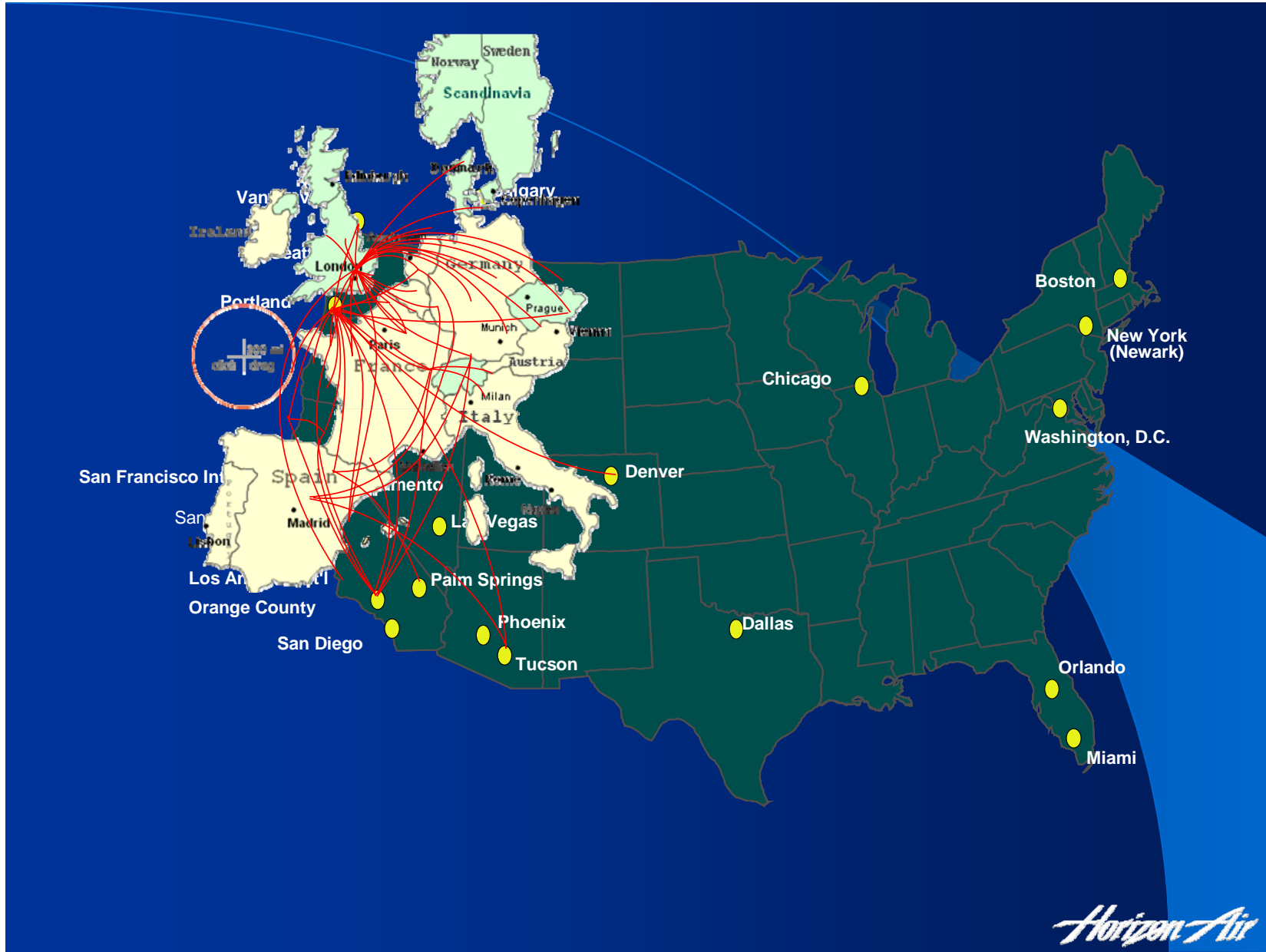
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INTRODUCTION

- Different development issues and strategies are apparent in the regional airline industries of Europe and North America
- Some emerging trends can be identified along with examples of 'best practice' in both markets

WESTERN EUROPE TO THE SAME SCALE AS THE US WITH HORIZON AIR'S NETWORK OVERLAID



TEN LARGEST REGIONAL AIRLINES - NORTH AMERICA

Airline	RPK 2006 (million)	Passengers 2006 (thousand)	Average length of pax haul (km)	Load factor %
Express Jet	16620	18331	907	78
SkyWest	15288	19496	784	79
American Eagle	13557	18766	722	75
Mesa	11096	15358	722	75
ASA	10106	11818	855	77
Comair	8516	10596	804	74
Pinnacle	6904	8988	768	76
Air Canada Jazz	6148	8700	707	72
Chautauqua	4543	6781	670	73
Horizon	4334	6860	632	74
Total of 10	97112	125694	773	76

TEN LARGEST REGIONAL AIRLINES - EUROPE

Airline	RPK 2006 (million)	Passengers 2006 (thousand)	Average length of pax haul (km)	Load factor %
Lufthansa Cityline	4036	6229	648	64
KLM City Hopper	3113	5227	596	72
Austrian Arrows	3037	4510	673	64
Air Nostrum	2836	5269	538	63
Flybe	2525	4537	557	63
Régional	2385	3884	614	62
Brit Air	2240	3963	565	64
BA Connect	2050	3303	621	59
Eurowings	1305	2497	523	61
Alitalia Express	1075	2013	534	69
Total of 10	24602	41432	594	64

FLEETS OF REGIONAL AIRLINES - NORTH AMERICA

Airline	Jet 51-100 seats	Jet up to 50 seats	T-prop 51-100 seats	T-prop up to 50 seats
Express Jet		274		
SkyWest	74	120		62
American Eagle	25	206		27
Mesa	56	63		30
ASA	31	112	11	
Comair	27	143		
Pinnacle		124		
Air Canada Jazz	15	58		62
Chautauqua		98		
Horizon	21		20	28
Total of 10	249	1198	31	209
	15%	71%	2%	12%

FLEETS OF REGIONAL AIRLINES - EUROPE

Airline	Jet 51-100 seats	Jet up to 50 seats	T-Prop 51-100 seats	T-Prop up to 50 seats
Lufthansa Cityline	50	26		
KLM City Hopper	41			14
Austrian Arrows	18	14	10	12
Air Nostrum	10	34	5	11
Flybe	10		27	
Régional	16	37		9
Brit Air	25	19		
BA Connect	21	28		10
Eurowings	14	17		
Alitalia Express	6	14	10	1
Total of 10	211	189	52	57
	41%	37%	10%	11%

SIZE OF REGIONAL AIRCRAFT

- The number of congested major hubs in Europe means precious runway slots cannot be wasted on small aircraft
e.g. at London Heathrow, Gatwick, Stansted and Luton only 5% of flights are with aircraft of under 100 seats (at US major airports equivalent figure is 40%)
- Shorter average stage lengths in Europe favour turbo-props
- Order book shows the big growth area to be 51-100 seat jets
295 orders in N America, 104 in Europe
Also 51-100 seat turbo-props
47 orders in N America, 69 in Europe
No orders for 0-50 seat jets and only 3 for 0-50 seat turbo-props
- Issue of who flies the larger regional jets

REGIONAL AIRCRAFT USAGE AT LONDON HEATHROW

with Monday-Friday frequencies

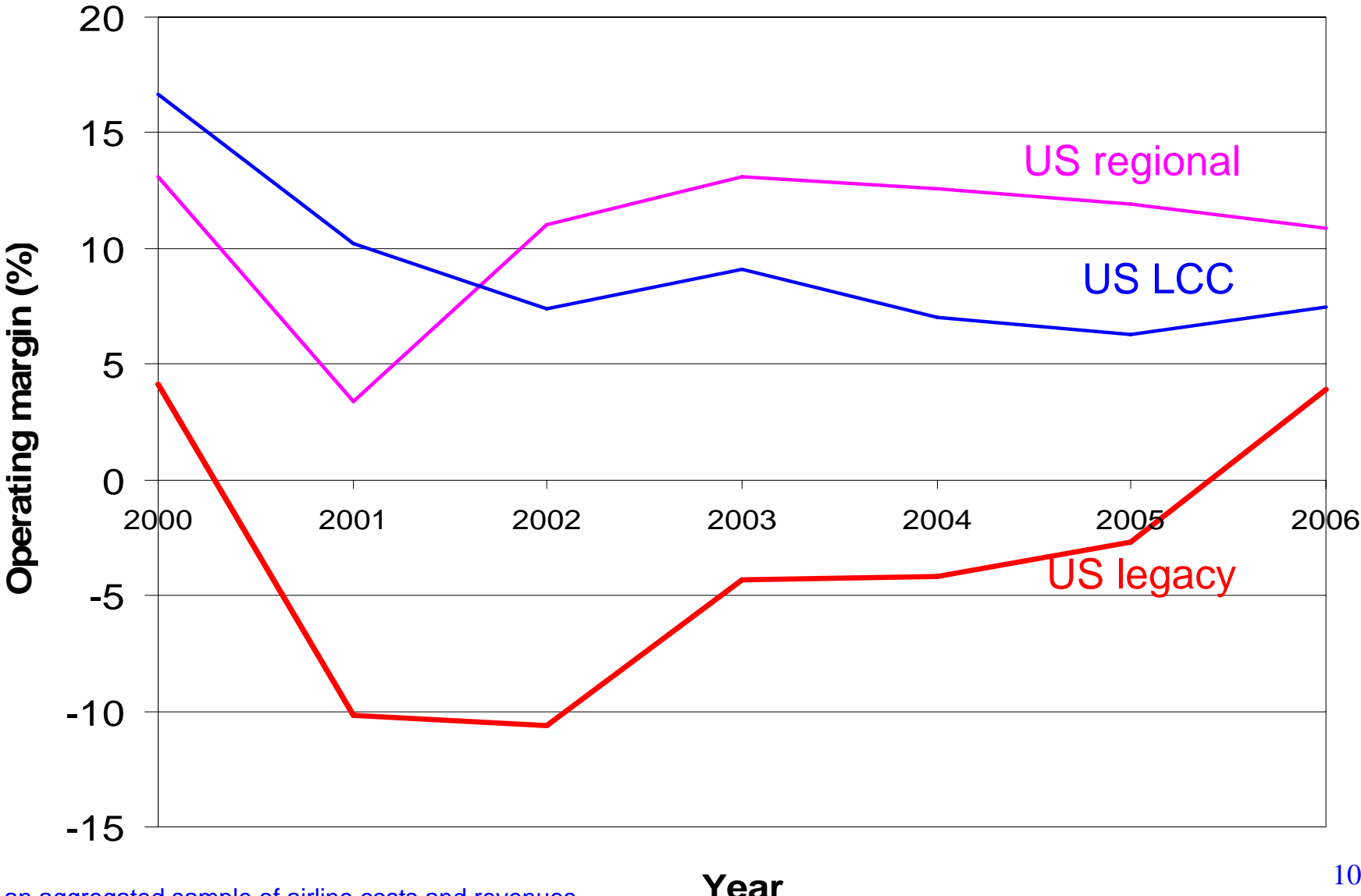
Heathrow: 20 frequencies (2007) -> 16 frequencies (2008)

bmi regional	Durham Tees Valley x4 (ERJ145) -> 3 Hanover x3 (ERJ145) Aberdeen off-peak x3 (ERJ145) Manchester off-peak x1 (ERJ145)
KLM City Hopper	Eindhoven x2 (F50) -> 0 Rotterdam x3 (F50) -> 2
Luxair	Luxembourg x2 (ERJ145)
Austrian	Vienna off-peak x2 (F100)

All other scheduled flights are with B737, A318 or larger

Source: Compiled from OAG Flight Guide July 2007, April 2008

INDICATIVE OPERATING MARGINS OF US CARRIER GROUPS 2000-06



Based on an aggregated sample of airline costs and revenues
Source: Compiled from IATA, Airline Business and Air Transport World data

DIFFERENT BUSINESS MODELS

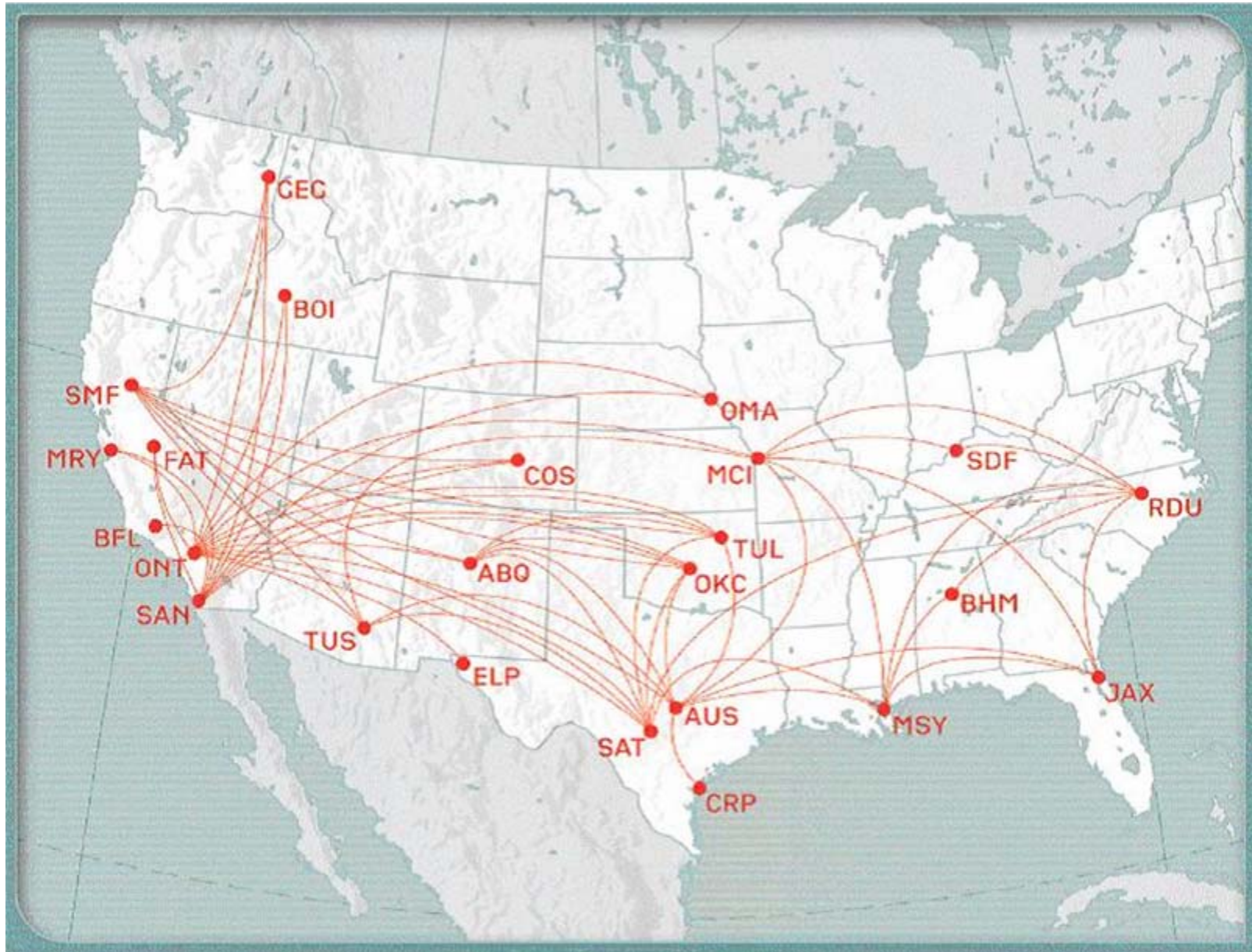
US regional airlines

- Capacity Purchase (e.g. Sky West and United)
- Wholly Owned Subsidiary (e.g. Comair and Delta)
- Independent, Native Network (e.g. Horizon and Alaska)
- Essential Air Service, Small Community Air Service Grants and Revenue Guarantees (e.g. Air Midwest)

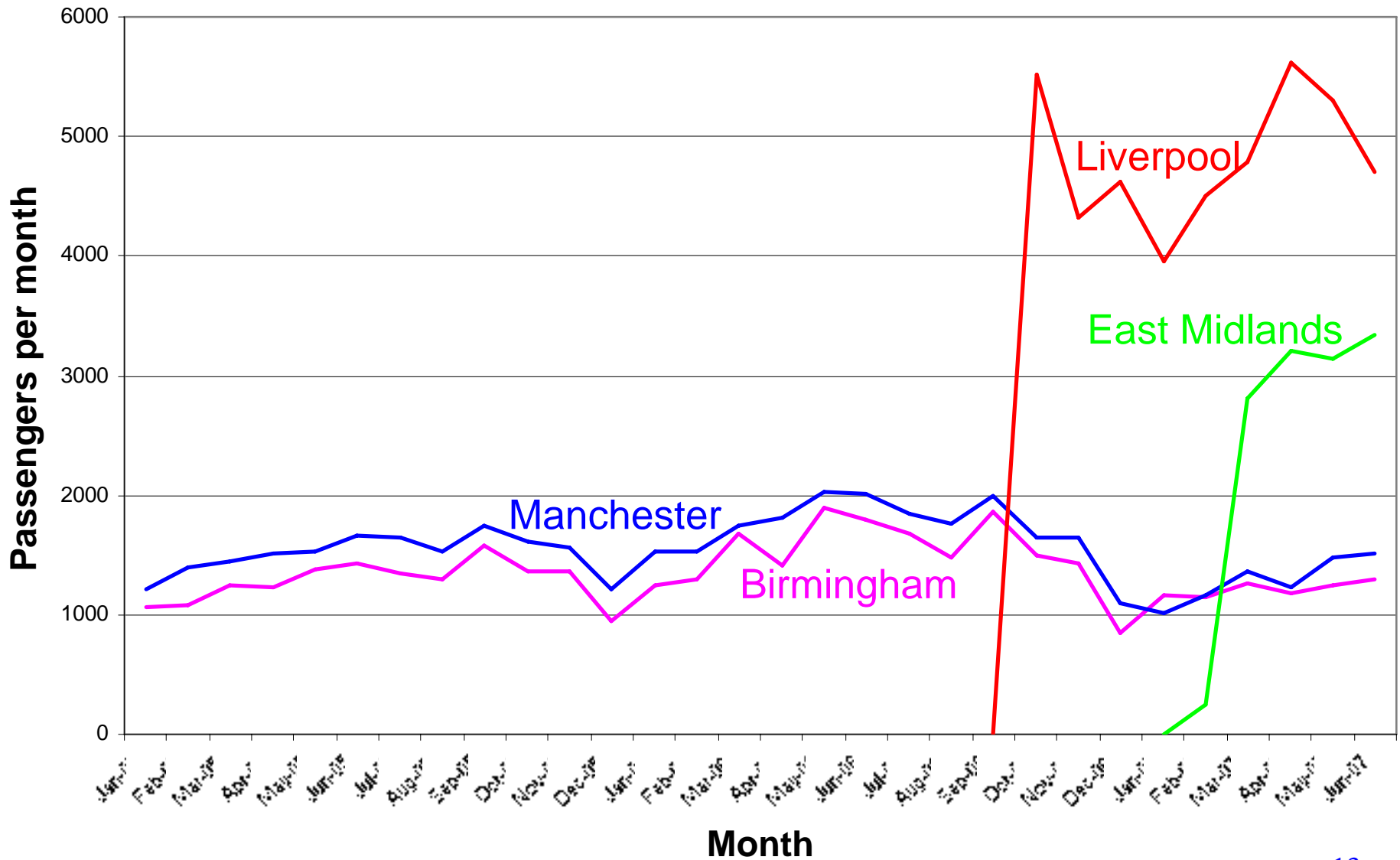
In Europe similar models exist but with a major extra one

- Franchising is one of the most common where services operate under the major carrier's brand but the costs, pricing and risk remain with the regional carrier

EXPRESSJET'S OWN BRANDED ROUTE NETWORK



TRAFFIC ON SELECTED ROUTES TO/FROM INVERNESS 2005-07



REGIONAL RESTRUCTURING IN EUROPE

Reduce costs through

- Fleet reorganisation
- Adoption of parts of the LCC model
e.g. direct sales, unbundled fares,
fast turn-arounds, use of less congested airports

BA Connect (British Airways' loss making regional arm)
sold to flybe in early 2007

flybe a hybrid regional/LCC specialising in markets
too thin or difficult for Ryanair and easyJet

- BA Connect's large ERJ145 fleet to be retired
- flybe moves to Dash 8-Q400 and ERJ195
- BA obtains 15% stake in flybe
- BA code-share maintained on relevant routes

COST BREAKDOWN FOR BA CONNECT AND FLYBE FINANCIAL YEAR ENDING 2006 (PRIOR TO MERGER)

	BA Connect USc per ASK	flybe USc per ASK
Flight & cabin crew	4.2	1.7
Fuel & oil	2.7	2.3
Aircraft incl maintenance	4.0	3.2
Airport, ground & en-route	3.9	4.1
Passenger services	0.8	0.3
Marketing & distribution	0.7	0.8
General & administrative	1.6	0.8
Total per ASK	18.0	13.2
Total per RPK	31.8	20.1

Source: Compiled from CAA data; exchange rates from Federal Reserve

POTENTIAL IMPACT ON PROFITABILITY

In financial year 2005/06

- BA Connect made a loss of \$77 million on turnover of \$716 million
- With flybe's costs per ASK this becomes a profit of \$111 million if revenue can be maintained

LONG-HAUL SERVICES: REGIONAL AND SECONDARY AIRPORTS

- Few of these services are by the national carrier, most are operated by a foreign airline based at the opposite end of the route
- New York is the key destination supporting a daily service from e.g. Edinburgh, Geneva and Venice (mostly Continental or Delta)
- Dubai emerging as the eastbound destination with daily service from e.g. Newcastle, Glasgow, Hamburg (Emirates)
- Ethnic routes feature strongly: VFR traffic based on past migratory patterns e.g. Shannon-Boston, Belfast-Toronto, Lyon-Montreal, Birmingham-Islamabad
- From German airports quasi-charter services operate to holiday destinations e.g. Leipzig-Puerto Plata, Dusseldorf-Orlando

ISSUES WITH REGIONAL LONG-HAUL SERVICES

- Propensity to travel much lower in regions
e.g. Wales is less than half London & SE England
- Compounded by lower yields in most cases
(less business traffic)
- Use of smaller aircraft (Boeing 757) on thin routes by
US carriers (all economy class in some cases)
- ‘Executive’ jets (A318 from London City, A319 from
Dusseldorf ; bmi British Midland investigated A319s
with conventional two-class cabin from Manchester)

CONCLUSIONS

- Growth in demand largely in leisure sector which favours lower cost aircraft rather than frequency
- European regional carriers must cut costs to survive; may be better to let major carriers take-over yield management
- US regionals need to reduce dependence on 50 seat jets and may be exposed to 'Ryanair' type low frequency competition
- As cost levels of major/legacy carriers become more competitive they may take flying back in-house leaving regionals to go it alone
- Long-haul services difficult from regional airports unless in a low frequency niche or operating from a major hub at the other end

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